

OR Tambo District Municipality Audit Report

For the year ended 30 June 2013

REPORT OF THE AUDITOR-GENERAL TO THE EASTERN CAPE PROVINCIAL LEGISLATURE AND THE COUNCIL OF OR TAMBO DISTRICT MUNICIPALITY

REPORT ON THE CONSOLIDATED FINANCIAL STATEMENTS

Introduction

1. I was engaged to audit the consolidated and separate financial statements of the OR Tambo District Municipality and its subsidiaries set out on pages ... to ..., which comprise the consolidated and separate statement of financial position as at 30 June 2013, the consolidated and separate statements of financial performance, changes in net assets, statement of budget comparison and cash flows for the year then ended, and the notes, comprising a summary of significant accounting policies and other explanatory information.

Accounting Officer's responsibility for the consolidated financial statements

2. The accounting officer is responsible for the preparation and fair presentation of these consolidated and separate financial statements in accordance with South African Statements of Generally Recognised Accounting Practice (SA Standards of GRAP) and the requirements of the Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA) and Division of Revenue Act of South Africa, 2010 (Act No. 1 of 2010 as amended) (DoRA), and for such internal control as the accounting officer determines is necessary to enable the preparation of consolidated and separate financial statements that are free from material misstatement, whether due to fraud or error.

Auditor-General's responsibility

3. My responsibility is to express an opinion on the consolidated and separate financial statements based on conducting the audit in accordance with the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA), the *General Notice* issued in terms thereof and International Standards on Auditing. Because of the matters described in the Basis for disclaimer of opinion paragraphs, I was unable to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

Basis for disclaimer of opinion

Consolidation of material subsidiary

4. The requirements of GRAP 6 – *Consolidated and separate financial statements*, have not been considered and applied by the entity for Kei Fresh Produce Market and due to inadequate information the impact upon the consolidated financial statements and respective notes to the consolidated financial statements, for this subsidiary could not be determined. Although adjustments to the financial statements were necessary, I was unable to determine what these adjustments should be as sufficient appropriate audit evidence was not provided.

Cash and cash equivalents

5. Sufficient appropriate audit evidence was not available to support cash and cash equivalents disclosed in note 3 to the financial statements. The validity of reconciling items identified could not be adequately supported. I was unable to confirm the cash and cash equivalents by alternative means due to inadequate support to verify authorisation of payments and resultant other components impacted. Consequently, I was unable to determine whether any adjustments were necessary to cash and cash equivalents of R227.6 million as disclosed in note 3 to the financial statements.

Infrastructure, property, plant and equipment

6. The municipality incorrectly recognised costs on assets and depreciation on land, buildings, heritage, finance lease and other assets which were not in line with the requirements of GRAP 17 – *Property, plant and equipment*. This resulted in understatement of depreciation amounting to R137 606 (2012: R1.2 million) and a resultant cumulative understatement of accumulated depreciation amounting to R1.4 million (2012: R1.2 million) and overstatement within accumulated surplus (2012: R7 180) due to inadequate controls over the recording and reconciling of movable assets.
7. In addition, sufficient appropriate audit evidence was not available for both the current and the comparative years and documentation in support of land, buildings, heritage, finance lease and other assets was either not submitted for audit purposes or that which was submitted, was insufficient. I was unable to confirm the land, buildings, heritage, finance lease and other assets by alternative means due to the inadequate document management and controls over asset movements. Consequently, I was unable to determine whether any further adjustments were necessary to land, buildings, heritage, finance lease and other assets of R269.9 million (2012: R281.1 million) as disclosed in note 10 and depreciation and amortisation of R177.7 million (2012: R1.3 billion) as disclosed in note 21 to the financial statements.
8. The municipality incorrectly recognised costs on assets and depreciation on infrastructure assets which were not in line with the requirements of GRAP 17 – *Property, plant and equipment*. This resulted in understatement of depreciation amounting to R155.0 million (2012: R1.7 billion) and a resultant cumulative understatement of accumulated depreciation amounting to R1.4 billion (2012: R1.7 billion) and overstatement within accumulated surplus for 2012 of R407.8 million due to inadequate controls over the recording cost information and depreciation not according to approved accounting policy as it relates to additions of infrastructure assets.
9. In addition, sufficient appropriate audit evidence was not available for both the current and the comparative years and documentation in support of infrastructure assets was either not submitted for audit purposes or that which was submitted, was insufficient. I was unable to confirm the infrastructure assets by alternative means due to the inadequate document management. Consequently, I was unable to determine whether any further adjustments were necessary to infrastructure assets of R2.1 billion (2012: R1.8 billion) as disclosed in note 10 and depreciation and amortisation of R177.7 million (2012: R1.3 billion) as disclosed in note 21 to the financial statements.

Employee related costs

10. Expenditure for employee related costs of R253.5 million (2012: R217.4 million) is disclosed in note 20 to the financial statements. Employee related costs are overstated by R1.8 million (2012: R63 262) with a resultant understatement of trade and other payables of R304 697 (2012: R63 262), understatement of other receivables from exchange transaction of R3.1 million and understatement of general expenses of R 908 844 as a result of inadequate systems in place to maintain personnel records to support basic salary, allowances and deductions.
11. In addition, the municipality does not have adequate systems in place to maintain employee files and as a result sufficient appropriate audit evidence was not available in support of basic salaries, casual wages, contributions and allowances. Due to the inadequate document management system I was unable to confirm this expenditure by alternative means. Consequently, I was unable to determine whether any further adjustments to employee related costs of R 253.5 million (2012: R 217.4 million) as disclosed in note 20 were necessary.

General expenses, bulk purchases and contracted services

12. The municipality incorrectly recognised items within general expenses and contracted services which met the definition of assets as per GRAP 17 – *Property, plant and equipment*. General expenses are overstated by R25.5 million with a resultant understatement within Infrastructure, Property, plant and equipment of R23.0 million, overstatement of trade and other payables of R3.5 million, understatement of VAT Receivable of R1.1 million (2012 R 6.1 million) and for 2012 an understatement within employee related costs of R27.4 million due to inadequate systems in place for the identification and recognition of assets and recognition of expenditure based on the nature of the expenditure.
13. In addition, sufficient appropriate audit evidence was not available for both the current and the comparative years and documentation in support general expenses, bulk purchases and contracted services was either not submitted for audit purposes or that which was submitted, was insufficient. General expenses contained journals amounting to at least R2.1 million to which the supporting information did not agree to the journal voucher or no sufficient appropriate audit evidence could be provided to verify the journal entries processed. I was unable to confirm the general expenses, bulk purchases and contracted services by alternative means due to the inadequate document management system. Consequently, I was unable to determine whether any further adjustments were necessary to general expenses, bulk purchases and contracted service of R566.3 million (2012: R481.0 million) as disclosed in note 24, 25 and 27 to the financial statements.

Government grants and subsidies and Obligations under transfer arrangement

14. The municipality incorrectly recognised transactions within general expenses which met the definition of assets as per GRAP 17 – *Property, plant and equipment*. Grant expenditure is overstated by R4.2 million (2012: R2.8 million) with a resultant understatement of government grants and subsidies revenue amounting to R975 687 (2012: R1.9 million), overstatement of VAT Receivable of R669 189, understatement of Infrastructure, Property, plant and equipment of R 1.2 million and overstatement of Trade and other payables of R3.2 million due to inadequate systems over differentiation of recording expenditure and assets transactions within the general ledger.
15. Conditional grants and subsidies as included within note 17 is overstated by R170.9 million (2012: R2 million) with a resultant understatement within obligations under transfer arrangement of R170.9 million due to early recognition of revenue where conditions on grant expenditure have yet to be met.
16. In addition, sufficient appropriate audit evidence was not available for the current and comparative years and documentation in support grant expenditure was either not submitted for audit purposes or that which was submitted, was insufficient. Government grant and subsidies contained journals amounting to at least R2.3 million to which the supporting information did not agree to the journal voucher or no sufficient appropriate audit evidence could be provided to verify the journal entries processed. I was unable to confirm the grant expenditure and related grant revenue by alternative means due to the inadequate document management. Consequently, I was unable to determine whether any further adjustments were necessary to conditional grants and subsidies revenue of R838.7 million (2012: R340.6 million) included under note 17 and Obligations under transfer arrangements of R205.6 million (2012: R393.6 million) as disclosed in note 14 to the financial statements.

Revenue from exchange transactions

17. The municipality did not recognise items that met the definition of revenue as per GRAP 9 – *Revenue from exchange transactions*, as required by the standard. Service charges revenue of R127.9 million (2012: R120.8 million) is disclosed in note 16. This revenue is understated by R4.6 million (2012: R 1.3 million) with a resultant understatement within trade receivables of R1.9 million as a result of differences on the recalculation of meter readings and estimates and overstatement within trade and other payables of R 2.7 million due to prescription of long outstanding debts owed by the municipality.
18. In addition, sufficient appropriate audit evidence was not available for both the current and the comparative years and documentation in support of the accuracy and completeness of service charges was either not submitted for audit purposes or that which was submitted, was incomplete. I was unable to confirm the revenue by alternative means due to the municipality not having adequate systems in place to account for the complete billing of service charges. Consequently, I was unable to determine whether any adjustments were necessary to service charges of R127.9 million (2012: R120.8 million) as disclosed in note 16 and material losses disclosure as required by the MFMA of R20.2 million (2012: R19.3 million) included in note 5.2 to the financial statements.

Other income

19. Included within other income as reflected within note 18 to the financial statements is an amount for VAT Refund amounting to R89.8 million. The municipality was unable to support the difference between the amount reflected and the amount as verified against the VAT 201's for the period. I was unable to confirm this income by alternative means. Consequently, I was unable to determine whether any adjustments to other income of R101.1 million as disclosed in note 18 to the financial statements were necessary.

Trade receivables from exchange transactions

20. The municipality did not adequately recognise an allowance for doubtful debts in terms of GRAP 104 – *Financial Instruments*. The municipality did not specifically identify debtors for consideration of impairment resulting in an overstatement of trade and other receivables from exchange transactions (2012: R 1.9 million) and an understatement of debt impairment of R9.8 million.
21. In addition, sufficient appropriate audit evidence was not available for both the current and the comparative years and documentation in support of trade and other receivables from exchange transactions was either not submitted for audit purposes or that which was submitted, was insufficient. I was unable to confirm the trade and other receivables from exchange transactions by alternative means due to the inadequate document management. Consequently, I was unable to determine whether any further adjustments were necessary to trade and other receivables from exchange transactions of R45.0 million as disclosed in note 4 to the financial statements.

VAT receivable

22. Sufficient appropriate audit evidence was not available to support VAT receivables disclosed in note 7 to the financial statements. The validity of reconciling items identified could not be adequately supported. As no documentation was submitted for audit purposes, I was unable to confirm the VAT receivable by alternative means. Consequently, I was unable to determine whether any adjustments were necessary to VAT receivable of R43.1 million as disclosed in note 7 to the financial statements.

Trade and other payables

23. The municipality did not recognise transactions that met the definition of trade and other payables as per GRAP 104 – *Financial Instruments*, as required by the standard. Trade and other payables is understated by R51.6 million (2012: R9.4 million) with a resultant understatement within general expenses of R49.7 million (2012: R9.4 million) and overstatement within Other Receivables of R1.9 million as a result of an inadequate system for the identification and recognition of accruals.
24. In addition, sufficient appropriate audit evidence was not available for both the current and comparative years and documentation in support of trade and other payables was either not submitted or that which was submitted, was incomplete. For the current period an unreconciled difference between the general ledger and disclosure amounts as noted within note 12 could not be supported. I was unable to confirm the trade and other payables by alternative means. Consequently, I was unable to determine whether any further adjustments were necessary to trade and other payables of R245.2 million (2012: R200.6 million) as disclosed in note 12 to the financial statements.

25. Included within trade and other payables within note 12 to the financial statements is an amount for accrual for leave amounting to R26.3 million. The municipality did not have adequate systems in place to capture and account for leave taken and as a result accrual for leave has been understated by R12.9 million with a related understatement within employee related costs of R12.9 million.

Inventories

26. The municipality did not recognise items that meet the definition of inventory as per GRAP 12 – *Inventory*, as required by the standard. Inventory is understated by R712 431 (overstated 2012: R 3.1 million) with a resultant overstatement within general expenses of R712 431 (understatement 2012: R 3.1 million) as a result of inadequate controls over the updating, issuing and management of the stock system.
27. The municipality entered into agreements to construct a number of assets during the current financial year. The requirements of GRAP 11 – *Construction contracts*, have not been considered and applied by the entity and due to inadequate systems and document management the impact upon the revenue, grant expenditure, inventory and infrastructure, property, plant and equipment and their respective notes to the financial statements, to these transactions could not be determined. Although adjustments to the financial statements were necessary, I was unable to determine what these adjustments should be as sufficient appropriate audit evidence was not provided.
28. In addition, sufficient appropriate audit evidence was not available for both the current and the comparative years and documentation in support inventory was either not submitted for audit purposes or that which was submitted, was insufficient. I was unable to confirm the inventory by alternative means due to the inconsistency between descriptions within the inventory listings and those per the supplier quotations. Consequently, I was unable to determine whether any further adjustments were necessary to inventories of R19.7 million (2012: R13.3 million) as disclosed in note 5 to the financial statements.

Commitments

29. The municipality did not have an adequate and complete contract management system in place for the identification and recognition of contracted commitments and did not include all commitments of the municipality in the amounts disclosed in disclosure note 35.1 to the financial statements, which resulted in an understatement of R375.1 million.
30. In addition, sufficient appropriate audit evidence was not available for both the current and comparative years and documentation in support of commitments was either not submitted or that which was submitted, was insufficient. I was unable to confirm the commitments by alternative means. Consequently, I was unable to determine whether any further adjustments were necessary to commitments of R1.2 billion (2012: R1.7 billion) as disclosed in note 35.1 to the financial statements.

Unauthorised expenditure

31. The municipality did not have adequate systems in place to identify and disclose all unauthorised expenditure incurred during the year as required by section 125(2)(d) of the MFMA. The unauthorised expenditure disclosed in note 40.1 to the financial statements is understated in respect of amounts incurred during the year that were identified during the audit process of R229.1 million (2012: R1.4 billion) with a resultant misstatement at year-end amounting to R1.6 billion.

Irregular expenditure

32. The municipality did not have adequate systems in place to identify and disclose all irregular expenditure incurred during the year as required by section 125(2)(d) of the MFMA. The irregular expenditure disclosed in note 40.3 to the financial statements is understated in respect of amounts incurred during the year that were identified during the audit process. Due to the lack of systems and non-availability of sufficient appropriate audit evidence for all awards, it was impracticable to determine the full extent of the understatement of irregular expenditure disclosed as R264.2 million (2012: R241.4 million).
33. In addition, sufficient appropriate audit evidence was not available for both the current and comparative years and documentation in support of irregular expenditure was either not submitted or that which was submitted, was insufficient. I was unable to confirm the irregular expenditure by alternative means. Consequently, I was unable to determine whether any further adjustments were necessary to irregular expenditure of R264.2 million (2012: R241.4 million) as disclosed in note 40.3 to the financial statements.

Contingent liability

34. Sufficient appropriate audit evidence was not available for contingent liabilities as disclosed in note 36 to the financial statements. Sufficient appropriate audit evidence was not available for the current year and documentation in support of contingent liabilities was either not submitted or that which was submitted, was insufficient. Therefore, I was unable to confirm contingent liabilities by alternate means. Consequently I was unable to determine whether adjustments to the contingent liabilities amounting to R34.5 million within the disclosure note were necessary.

Budget versus actual

35. GRAP 1 - *Presentation of financial statements* requires that a full set of financial statements includes a comparison of budget and actual amounts either as a separate additional financial statement or as a budget column in the financial statements, when the entity makes its approved budget publicly available. The final budget amounts for net cash from (used) operating and resultant cash/cash equivalents at the year-end is understated by R34.7 million when compared to the approved final budget.
36. The municipality did not provide reasons for material budget variances within the statement of budget comparison as required in terms of GRAP 24 – *Presentation of budget information in the financial statements*.

Aggregation of immaterial uncorrected misstatements

37. The financial statements as a whole are materially misstated due to the cumulative effect of numerous individually immaterial uncorrected misstatements in the following elements making up the statement of financial position and the notes to the financial statements:
- Fruitless and wasteful expenditure of R15.1 million included in note 40.2 to the financial statements is understated by R861 142 with a resultant overstatement of irregular expenditure of this amount.
 - Repairs and maintenance as disclosed in the statement of financial performance is overstated by R10.4 million.

38. In addition, I was unable to obtain sufficient appropriate audit evidence resulting in my inability to confirm the following elements by alternative means:
- Finance income – other included note 19 to the financial statements.
 - Investment properties included in note 9 to the financial statements.
 - Fruitless and wasteful expenditure included in note 40.2 to the financial statements.
 - Accumulated surplus included within the statement of changes in net assets and related prior period error note 32.
 - Repairs and maintenance as disclosed in the statement of financial performance.
39. As a result, I was unable to determine whether any further adjustments to these elements were necessary.

Corresponding figures

40. During 2011-12, I identified the following misstatements which are still included in the corresponding figures disclosed in the current period's financial statements:

Statement of cash flows

41. Standards of Generally Recognised Accounting Practice, GRAP 2 - *Cash flow statements*, requires that the financial statements present fairly the financial position, financial performance and cash flows of an municipality. Internal controls were not put in place to ensure that the financial statements are accurate.
42. Provision for impairment losses of R105.2 million for Trade and other receivables have not been appropriately included as a non cash movement. Further, movement within employee related accruals amounting to R1.7 million were included within both payments to suppliers and employee related payments within cash generated from operations disclosed in the statement of cash flows, and note 30 to the financial statements.
43. The impact of prior period errors as disclosed in note 32 have not been disclosed within the categories of the statement of cash flows. This adjustment is required as the corresponding figures have been updated to reflect the adjustment within note 32 as required by GRAP 3 - *Accounting policies, changes in accounting estimates and errors*. Further, unsupported prior year adjustments amounting to R17.3 million have been included within payments to suppliers.
44. Consequently, I was unable to satisfy myself regarding the accuracy and completeness of the statement of cash flows and note 30 to the financial statements.

Additional disclosures in terms of the MFMA

45. Sufficient appropriate audit evidence was not available for the comparative years and documentation in support of PAYE, SDL and UIF amounting to R 37.4 million and Pension medical aid deductions amounting to R35.7 million and councillor's arrear consumer accounts amounting to R150 409 was either not submitted for audit purposes or that which was submitted, was insufficient. I was unable to confirm the additional disclosures in terms of the MFMA by alternative means due to the inadequate document management. Consequently, I was unable to determine whether any further adjustments were necessary to the additional disclosures in terms of the MFMA as disclosed in note 41.4, 41.5 and 41.6 to the financial statements.

Disclaimer of opinion

46. Because of the significance of the matters described in the Basis for disclaimer of opinion paragraphs, I have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. Accordingly, I do not express an opinion on these financial statements.

Emphasis of matters

47. I draw attention to the matters below. My opinion is not modified in respect of these matters.

Significant uncertainties

48. With reference to note 36 to the financial statements, the municipality is the defendant in a number of lawsuits estimated costs at R34.5 million (2012: R14.1 million). The municipality is opposing the claims. The ultimate outcome of the matters cannot presently be determined and no provision for any liability that may result has been made in the financial statements.

Restatement of corresponding figures

49. As disclosed in note 32 to the financial statements, the corresponding figures have been restated as a result of errors only corrected during the year ended 30 June 2013 that existed in the financial statements at, and for the year ended, 30 June 2012.

Material impairments

50. The municipality has made allowances for material impairments as disclosed in note 4.1 - Trade Receivables amounting to R296.0 million (2012: R221.1 million) and note 6.1 - Other receivables from exchange transactions amounting to R87.1 million (2012: R80.2 million) which are related to receivables that were not considered recoverable. This impairment is necessary due to poor collection practices and non-implementation of policies. No write-off against the impairment provisions have been made during the year.

Material underspending of the conditional grant

51. The municipality materially under spent on its conditional grants. As disclosed in note 14.1 to the financial statements, R205.6 million (2012: R393.6 million) of the conditional grant funds remained unspent at 30 June 2013.

Additional matters

52. I draw attention to the matters below. My opinion is not modified in respect of these matters.

Unaudited supplementary schedules

53. The supplementary information set out on page xx does not form part of the financial statements and is presented as additional information. We have not audited these schedules and, accordingly, we do not express an opinion thereon.

Withdrawal from audit engagement

54. Due to the numerous limitation and disagreement misstatements identified in the financial statements, we are unable to rule out the possibility of fraud which calls into question the reliability of evidence obtained and the authenticity of the accounting records and documentation. But for the legislated requirement to perform the audit of municipality, I would have withdrawn from the engagement in terms of the ISAs.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

55. In accordance with the PAA and the *General Notice* issued in terms thereof, I report the following findings relevant to performance against predetermined objectives, compliance with laws and regulations and internal control, but not for the purpose of expressing an opinion.

Predetermined objectives

56. I performed procedures to obtain evidence about the usefulness and reliability of the information in the annual performance report as set out on pages 87 to 124 of the annual report.
57. The reported performance against predetermined objectives was evaluated against the overall criteria of usefulness and reliability. The usefulness of information in the annual performance report relates to whether it is presented in accordance with the National Treasury's annual reporting principles and whether the reported performance is consistent with the planned objectives. The usefulness of information further relates to whether indicators and targets are measurable (i.e. well defined, verifiable, specific, measurable and time bound) and relevant as required by the *National Treasury Framework for managing programme performance information*.

The reliability of the information in respect of the selected programmes is assessed to determine whether it adequately reflects the facts (i.e. whether it is valid, accurate and complete).

58. The material findings are as follows:

Usefulness of information

59. Section 46 of the Municipal Systems Act (MSA) requires disclosure in the annual performance report of measures taken to improve performance where planned targets were not achieved. Measures to improve performance for a total of 100% of the planned targets not achieved were not reflected in the annual performance report. This was due to improper review of the annual performance report prior to finalization and submission.

60. The MSA, section 41(c) requires that the integrated development plan should form the basis for the annual report, therefore requiring consistency of objectives, indicators and targets between planning and reporting documents. A total of 39% of the reported targets are not consistent with the targets as per the approved integrated development plan. This is due to the lack of improper review of the annual performance report prior to finalization and submission.
61. The National Treasury Framework for managing programme performance information (FMPPI) requires that indicators should have clear unambiguous data definitions so that data is collected consistently and is easy to understand and use. A total of 100% of the indicators were not well defined in that clear, unambiguous data definitions were not available to allow for data to be collected consistently. This was due to the fact that management was not aware of the requirements of the FMPPI.
62. The FMPPI requires that performance targets be specific in clearly identifying the nature and required level of performance. A total of 100% of the targets were not specific in clearly identifying the nature and the required level of performance. This was due to the fact that management was not aware of the requirements of the FMPPI.

Reliability of information

63. The FMPPI requires that institutions should have appropriate systems to collect, collate, verify and store performance information to ensure valid, accurate and complete reporting of actual achievements against planned objectives, indicators and targets.
64. I was unable to obtain the information and explanations I considered necessary to satisfy myself as to the reliability of information presented with respect to Basic Service Delivery, Local Economic Development and Infrastructure Development.
65. This was due to limitations placed on the scope of my work due to the fact that the institution could not provide sufficient appropriate evidence in support of the information presented with respect to the programme and the institutions records did not permit the application of alternate audit procedures.

Compliance with laws and regulations

66. I performed procedures to obtain evidence that the entity has complied with applicable laws and regulations regarding financial matters, financial management and other related matters. My findings on material non-compliance with specific matters in key applicable laws and regulations as set out in the *General Notice* issued in terms of the PAA are as follows:

Strategic and annual planning process

67. The municipal council did not consult with the local community in the drafting and implementation of the municipality's IDP, as required by section 28 of the MSA and Municipal planning and performance management regulation 15(1)(a)(i).
68. The municipality did not afford the local community at least 21 days to comment on the final draft of its integrated development plan before the plan was submitted to council for adoption, as required by Municipal planning and performance management regulation 15(3).
69. The municipal council did not review its integrated development plan, as required by section 34 of the MSA and Municipal planning and performance management regulation 3.

70. The municipality did not establish a performance management system, as required by section 38(a) of the MSA.
71. The performance management system of the municipality was not in line with the priorities, objectives, indicators and targets contained in its integrated development plan, did not clarify the roles and responsibilities of each role-player in the functioning of the system, did not determine the frequency of reporting and the lines of accountability for performance, did not relate to the municipality's performance management processes and did not provide for procedures by which the system is linked to the municipality's integrated development planning processes, as required by section 38(a) of the MSA and Municipal planning and performance management regulation 7(2)(c, e, f and g).
72. The performance management system of the municipality did not provide for the monitoring of performance and for the measuring and review of performance at least once per year, with regard to each of those development priorities and objectives and against the key performance indicators and targets set, as required by section 41 of the MSA.
73. The performance management system of the municipality did not provide for taking steps to improve performance with regard to those development priorities and objectives where performance targets are not met, as required by section 41 (1)(d) of the MSA.
74. The municipality did not establish mechanisms to monitor and review its performance management system, as required by section 40 of the MSA.
75. The municipality did not set key performance indicators, including input indicators, output indicators and outcome indicators, in respect of each of the development priorities and objectives set out in the IDP, as required by section 41(1)(a) of the MSA and the Municipal planning and performance management regulation 1 and 9(1)(a).
76. The municipality did not set measurable performance targets for the financial year with regard to each of the development priorities and objectives and key performance indicators set out in the IDP, as required by section 41(1)(b) of the MSA and the Municipal planning and performance management regulation 12(1) and 12(2)(e).

Planning and budget process

77. Revisions to the service delivery and budget implementation plan were not approved by the council after the approval of the adjustments budget, as required by section 54(1)(c) of the MFMA.

Audit committee

78. The audit committee did not review the municipality's performance management system or make recommendations to the council, as required by Municipal planning and performance management regulation 14(4)(a)(ii).
79. The audit committee did not submit, at least twice during the financial year, an audit report on the review of the performance management system to the council, as required by Municipal planning and performance management regulation 14(4)(a)(iii).

Internal audit

80. The internal audit unit did not assess the functionality of the performance management system, as required by Municipal planning and performance management regulation 14(1)(b)(i).
81. The internal audit unit did not assess the extent to which the performance measurements were reliable in measuring the performance of the municipality on key and general performance indicators, as required by Municipal planning and performance management regulation 14(1)(b)(iii).

Annual reporting process

82. The annual performance report for the year under review does not include the performance of the municipality and each external service provider, a comparison of the performance with set targets and measures taken to improve performance, as required by section 46 (1)(a) (b) (c) of the MSA.

Effective, efficient and transparent system and internal controls

83. The municipality did not have and maintain effective, efficient and transparent systems of financial and risk management and internal controls as required by section 62(1)(c)(i) of the MFMA.

Expenditure management

84. Money owing by the municipality was not always paid within 30 days or an agreed period, as required by section 65(2)(e) of the MFMA.
85. Sufficient appropriate audit evidence could not be obtained that payments were approved by the accounting officer or a properly authorised official as required by section 11(1) of the MFMA.
86. An effective system of expenditure control, including procedures for the approval, authorisation, withdrawal and payment of funds, was not in place, as required by section 65(2)(a) of the MFMA.
87. An adequate management, accounting and information system was not in place which accounted for creditors, as required by section 65(2)(b) of the MFMA.
88. Reasonable steps were not taken to prevent unauthorised expenditure, irregular expenditure and fruitless and wasteful expenditure, as required by section 62(1)(d) of the MFMA.

Transfer of funds and conditional grants

89. The municipality did not submit quarterly performance reports to the transferring national officer, the (relevant provincial treasury) and the National Treasury, within 30 days after the end of each quarter, as required by section 12(2)(c) of the Division of Revenue Act (DoRA).
90. The municipality did not evaluate its performance in respect of programmes funded by the Municipal infrastructure grant /submit the evaluation to the transferring national officer within two months after the end of the financial year, as required by section 12(5) of the DoRA.
91. The municipality did not submit project implementation plans to the national department (CoGTA), as required by the Division of Revenue Grant Framework, Gazette No.35399.

92. Sufficient appropriate audit evidence could not be obtained that the allocation for the Local Government Financial Management Grant was utilised for purposes other than those stipulated in the grant framework, in contravention of section 16(1) of the DoRA.
93. The municipality did not evaluate its performance in respect of programmes funded by the Local Government Financial Management Grant and submit the evaluation to the transferring national officer within two months after the end of the financial year, as required by section 12(5) of the DoRA.
94. Sufficient appropriate audit evidence could not be obtained that the allocation for the Municipal Systems Improvement Grant was utilised for purposes other than those stipulated in the grant framework, in contravention of section 16(1) of the DoRA.
95. The municipality did not evaluate its performance in respect of programmes funded by the Municipal Systems Improvement Grant and submit the evaluation to the transferring national officer within two months after the end of the financial year, as required by section 12(5) of the DoRA.
96. The municipality did not submitted, within 10 days after the end of each month, its monthly expenditure reports to the national department (CoGTA), as required by the Division of Revenue Grant Framework, Gazette No.35399.
97. The municipality did not comply with the preparations for the next financial year and the 2014/15 financial year as required by section 26 of the DoRA in that:
 - provisional allocations and projects to be funded from the conditional grant allocations were not agreed with category B municipality within its area of jurisdiction by 2 October 2012.
 - provincial allocations and projects to be funded from the allocations for the next financial year were not submitted to the national transferring officer.
 - the final allocations were not submitted to the National Treasury by 7 December 2012.

Revenue management

98. A credit control and debt collection policy was not maintained, as required by section 96(b) of the MSA and section 62(1)(f)(iii) of MFMA.
99. An effective system of internal control for debtors and revenue was not in place, as required by section 64(2)(f) of the MFMA.

Asset management

100. An adequate management, accounting and information system which accounts for assets was not in place, as required by section 63(2)(a) of the MFMA.
101. An effective system of internal control for assets including an asset register was not in place, as required by section 63(2)(c) of the MFMA.

Liability management

102. An adequate management, accounting and information system which accounts for liabilities was not in place, as required by section 63(2)(a) of the MFMA.
103. An effective system of internal control for liabilities (including a liability register) was not in place, as required by section 63(2)(c) of the MFMA.

104. Long-term debt was incurred without a resolution of the municipal council approving the debt agreement, in contravention of section 46(2) of the MFMA.

Consequences management

105. Unauthorised expenditure incurred by the municipality was not investigated to determine if any person is liable for the expenditure, in accordance with the requirements of section 32(2) of the MFMA.
106. Irregular expenditure incurred by the municipality was not investigated to determine if any person is liable for the expenditure, in accordance with the requirements of section 32(2) of the MFMA.
107. Fruitless and wasteful expenditure incurred by the municipality was not investigated to determine if any person is liable for the expenditure, in accordance with the requirements of section 32(2) of the MFMA.
108. The accounting officer did not always report cases of irregular conduct that constituted a crime to the South African Police Service, as required by SCM regulation 28(1)(b).
109. Allegations of financial misconduct against senior managers were not always tabled before council, as required by Local Government: Disciplinary Regulations for Senior Managers 5(2).
110. Cases of financial misconduct which constitute a crime committed by senior managers were not always reported to the South African Police Service, as required by section 62(1)(e) of the MFMA.
111. Investigations were not instituted into all allegations of financial misconduct against officials of the municipality, as required by section 171(4)(a) of the MFMA.
112. Disciplinary proceedings were not instituted against officials of the municipality, when investigations warranted such a step, as required by section 171(4)(b) of the MFMA.
113. Cases of financial misconduct which constitute a crime were not always reported to the South African Police Service, as required by section 62(1)(e) of the MFMA.

Budget, annual financial statements and annual report

114. Expenditure was incurred in excess of the limits of the amounts provided for in the votes of the approved budget, in contravention of section 15 of the MFMA.
115. Unforeseeable and unavoidable expenditure incurred by the municipality was not appropriated in an adjustment budget, as required by section 29(2)(d) of the MFMA.
116. Expenditure was approved as unforeseen and unavoidable which was considered by the council but not included in the approved annual budget, in contravention of Municipal Budget and Reporting Regulation 71(2).
117. The total unforeseen and unavoidable expenditure incurred exceeded R15 million, in contravention of Municipal Budget and Reporting Regulation 72.
118. The 2012/13 adjustment budget was not approved by the council, as required by Municipal Budget and Reporting Regulation 25.
119. Sufficient appropriate audit evidence could not be obtained that monthly budget statements were submitted to the relevant provincial treasury, as required by section 71(1) of the MFMA.

120. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the MFMA. Material misstatements identified by the auditors in the submitted financial statements were not adequately corrected, which resulted in the financial statements receiving a disclaimer of audit opinion.
121. The consolidated annual financial statements (AFS) did not incorporate the AFS of Kei Fresh Produce Market, as required by section 122(2) of the Municipal Finance Management Act.
122. The 2011/12 annual report was not tabled in the municipal council within seven months after the end of the financial year, as required by section 127(2) of the MFMA.
123. A written explanation was not submitted to council setting out the reasons for the delay in the tabling of the 2011/12 annual report in the council, as required by section 127(3) and 133(1)(a) of the MFMA.
124. The 2011/12 annual report was not made public immediately after the annual report was tabled in the council, as required by section 127(5)(a) of the MFMA.
125. The annual report for the year under review does not include an assessment by the accounting officer of any arrears on municipal taxes and service charges, the accounting officer's assessment of the municipality's performance against measurable performance objectives for revenue collection from each revenue source and for each budget vote, particulars of any corrective action taken or to be taken in response to issues raised in the audit report and the report of the audit committee, as required by section 121(3)(a), (b), (d), (e), (f) and (g) of the MFMA.

Human resources management

126. Job descriptions were not established for all posts in which appointments were made in the current year, in contravention of section 66(1)(b) of Municipal Systems Act.
127. We were unable to determine whether the accounting officer met any of the prescribed competency areas as required by sec 83 of the Municipal Finance Management Act and regulation 2 and 3 of the Municipal Regulations on Minimum Competency Levels.
128. Numerous senior managers did not have the higher education qualification as required by regulation 6 and 7 of the Municipal Regulations on Minimum Competency Levels.
129. Finance officials at middle management did not meet any of the prescribed competency areas as required by regulation 8 and 9 of the Municipal Regulations on Minimum Competency Levels.
130. The municipality did not develop and adopt appropriate systems policies and procedures to monitor, measure and evaluate performance of staff in contravention of MSA sec 67(d).

Procurement and contract management

131. Sufficient appropriate audit evidence could not be obtained that goods and services with a transaction value of below R200 000 were procured by means of obtaining the required price quotations, as required by SCM regulation 17(a) & (c).

132. Quotations were accepted from prospective providers who are not registered on the list of accredited prospective providers and do not meet the listing requirements prescribed by the SCM policy in contravention of SCM regulation 16(b) and 17(b).
133. Sufficient appropriate audit evidence could not be obtained that goods and services of a transaction value above R500 000 were procured by means of inviting competitive bids, as required by SCM regulation 19(a) and 36(1).
134. Sufficient appropriate audit evidence could not be obtained that bid specifications for procurement of goods and services through competitive bids were drafted in an unbiased manner that allowed all potential suppliers to offer their goods or services, as per required by SCM regulation 27(2)(a).
135. Sufficient appropriate audit evidence could not be obtained that bid specifications were drafted by bid specification committees which were composed of one or more officials of the municipality as required by SCM regulation 27(3).
136. Sufficient appropriate audit evidence could not be obtained that invitations for competitive bidding were advertised for a required minimum period of days, as required by SCM regulation 22(1) & 22(2).
137. Sufficient appropriate audit evidence could not be obtained that bids were evaluated by bid evaluation committees which were composed of officials from the departments requiring the goods or services and at least one SCM practitioner of the municipality as required by SCM regulation 28(2).
138. Sufficient appropriate audit evidence could not be obtained that contracts and quotations were awarded to bidders based on points given for criteria that were stipulated in the original invitation for bidding and quotations, as required by SCM Regulations 21(b) and 28(1)(a) and Preferential Procurement Regulations.
139. Sufficient appropriate audit evidence could not be obtained that bid adjudication was always done by committees which were composed in accordance with SCM regulation 29(2).
140. Awards were made to bidders other than those recommended by the bid evaluation committee without ratification by the accounting officer, as required by SCM regulation 29(5)(b).
141. Sufficient appropriate audit evidence could not be obtained that the preference point system was applied in all procurement of goods and services above R30 000 as required by section 2(a) of the Preferential Procurement Policy Framework Act and SCM regulation 28(1)(a).
142. Sufficient appropriate audit evidence could not be obtained that contracts and quotations were awarded to suppliers based on preference points that were allocated and calculated in accordance with the requirements of the Preferential Procurement Policy Framework Act and its regulations.
143. Sufficient appropriate audit evidence could not be obtained that contracts and quotations were awarded to bidders that scored the highest points in the evaluation process, as required by of section 2(1)(f) of Preferential Procurement Policy Framework Act.
144. Sufficient appropriate audit evidence could not be obtained that contracts were only extended or modified after tabling the reasons for the proposed amendment in the council of the municipality as required by section 116(3) of the MFMA.

145. Sufficient appropriate audit evidence could not be obtained that all extension or modification to contracts were approved by a properly delegated official, as required by SCM Regulation 5.
146. The performance of contractors or providers was not monitored on a monthly basis, as required by section 116(2)(b) of the MFMA.
147. The contract performance and monitoring measures and methods were insufficient to ensure effective contract management, as required by section 116(2)(c) of the MFMA.
148. Sufficient appropriate audit evidence could not be obtained that construction contracts were awarded to contractors that were registered with the Construction Industry Development Board (CIDB) in accordance with section 18(1) of the CIDB Act.
149. Construction projects were not always registered with the CIDB, as required by section 22 of the CIDB Act and CIDB regulation 18.
150. Sufficient appropriate audit evidence could not be obtained that contract and quotations were only awarded to providers whose tax matters have been declared by the South African Revenue Service to be in order as required by SCM regulation 43.
151. Sufficient appropriate audit evidence could not be obtained that contracts and quotations were awarded only to bidders who submitted a declaration on whether they are employed by the state or connected to any person employed by the state, as required by SCM regulation 13(c).
152. Awards were made to providers who are persons in the service of the municipality in contravention of section 112(j) of the MFMA and SCM regulations 44. Furthermore the provider failed to declare that he/she was in the service of the municipality, as required by SCM regulation 13(c). Similar non-compliance was reported in the prior year and the municipality did not take disciplinary action against the suppliers and officials involved.
153. Awards were made to providers who are persons in service of other state institutions or whose directors/ principal shareholders are persons in service of other state institutions where possible conflict of interest exists, in contravention of MFMA 112(j) and SCM regulations 44. Similar awards were identified in the prior year and no effective steps were taken to prevent or combat the abuse of the SCM process in accordance with SCM regulation 38(1).
154. Awards were made to providers who are persons in service of other state institutions or whose directors/ principal shareholders are persons in service of other state institutions where possible conflict of interest exists, in contravention of MFMA 112(j) and SCM regulations 44. Similar awards were identified in the prior year and no effective steps were taken to prevent or combat the abuse of the SCM process in accordance with SCM regulation 38(1).
155. Persons in the service of the municipality who had a private or business interest in contracts awarded by the municipality failed to disclose such interest, as required by SCM regulation 46(2)(e)/ the code of conduct for councillors issued in terms of the MSA and the code of conduct for staff members issued in terms of the MSA.
156. Persons in service of the municipality whose close family members had a private or business interest in contracts awarded by the municipality failed to disclose such interest, as required by SCM regulation 46(2)(e) and the code of conduct for councillors issued in terms of the MSA and the code of conduct for staff members issued in terms of the MSA.

157. Other SCM role players who or whose close family members had a private or business interest in contracts awarded by the municipality participated in the process relating to that contract, in contravention of SCM regulation 46(2)(f).
158. A list of accredited prospective providers was not in place for procuring goods and services through quotations as required by SCM regulation 14(1)(a).

Internal control

159. I considered internal control relevant to my audit of the financial statements, annual performance report and compliance with laws and regulations. The matters reported below under the fundamentals of internal control are limited to the significant deficiencies that resulted in the basis for disclaimer of opinion, the findings on the annual performance report and the findings on compliance with laws and regulations included in this report.

Leadership

160. The accounting officer and council have failed to ensure that the Human Resources unit manages the staffing requirements within the municipality through the appointment and retention of adequate and sufficiently skilled resources within an updated and approved operational organisational structure. As a result, the municipality does not appear to be sufficiently staffed in order to ensure the fair presentation of financial statements and reporting on predetermined objectives and compliance with laws and regulations.
161. The municipality did not have adequate controls and processes in place to ensure compliance with applicable legislation. Further, there is inadequate oversight by senior officials to ensure that policies, procedures and controls are implemented correctly.

Financial and performance management

162. The municipality remains reliant on the use of consultants to perform financial administration and reporting functions that should be performed by the staff employed by the municipality. A poor control environment over financial reporting exists as extensive manual reconciliation of accounting records and supporting schedules is required at year end as these controls are not performed on a regular ongoing basis during the year. Further, there is a lack of segregation of duties as reliance is placed on a few key personnel to perform crucial functions. This has the impact of limiting supervision and monitoring.
163. Weaknesses were identified in the record keeping of the municipality in that recorded transactions do not always have adequate supporting documentation or the supporting documentation is not readily available. This was evidenced by ten (10) non-submission letters being issued as the municipality was unable to provide the relevant supporting documentation for transactions within investment property, infrastructure assets, employee costs, inventory, operating expenditure, grant revenue and procurement as well as portfolios of evidence to support the audit of performance objectives.
164. The systems or processes for the preparation and reporting of the annual financial statements are not adequate or sufficient as the municipality has no formally adopted, and tailored, system or procedure manual which sets out processes to follow, controls in place, as well as responsible officials for the preparation, collation and reporting of the annual financial statements as there was no control to ensure the correct set of financial statements were provided for audit.

165. The systems or processes for the preparation and reporting of performance against predetermined objectives are not adequate or sufficient as the municipality has no formally adopted, and tailored, system or procedure manual which sets out processes to follow, controls in place, as well as responsible officials for the preparation, collation, reporting and monitoring of performance against predetermined objectives.

Governance

166. Insufficient action was taken by the governance structures within the municipality during the year under review to ensure that risks relating to the monitoring and reporting of financial information as well as performance objectives were addressed. Management failed to implement the recommendations of the internal audit unit which resulted in external audit findings within the current year. This has contributed to repeat audit findings in a number of areas.
167. The audit committee held regular meetings as required by the MFMA. However, the audit committees' ability to provide assurance was limited due to the inadequacy of the financial reports provided for their review. The audit committee also highlighted that the poor reporting culture within the municipality needs urgent management attention.

OTHER REPORTS

Investigations

168. An investigation relating to the allegations of abuse of the hired vehicles by the office of the executive mayor has been concluded however it is still to be presented to council.

Auditor - General

East London

12 December 2013



**AUDITOR - GENERAL
SOUTH AFRICA**

Auditing to build public confidence